RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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LETTER 892 **JULY 25, 1984**

THE MARKETS: What are the dominant trends today?

Stock market: The five criteria that I use to gauge the stock market read as follows:

(1) The Dow Theory continues to tell us that this is a primary bear market.

(2) My Primary Trend Index (PTI) hit a new bear market low of 1559 on July 10. The trend of the PTI remains bearish.

(3) The *Bank Credit Analyst* (latest July edition) states: "Indicators deteriorate further; basic trend of stock and bond prices remains down." The BCA's debit/loan ratio (which is an excellent indicator of forthcoming corporate liquidity and profits) is plunging.

(4) Trendex's "Long Term Probability Pattern for the NYSE Index" continues bearish, having turned down on Feb. 1, 1984 (Trendex is out of San Antonio).

(5) Lowry's "Buying Power and Selling Pressure" lines are still in the bearish mode with long-term selling pressure holding well above buying power (Lowry's publishes from Palm Beach).

(6) I am adding Ned Davis' excellent "Big Mo" indicator to my list, and Big Mo is currently bearish at minus 40 (Davis at 1-800/241-0621.

So as far as the stock market is concerned, the important primary trend indices that I follow remain bearish, and the long-term trend of stocks continues decisively down.

Commodities continue to look very bearish. The implications here are clearly deflationary.

Gold and precious metals remain in bearish trends, and again this is deflationary.

Bonds: The trend here is "hopeful." More about this later.

Inflation: With the general collapse in gold and commodities, I don't see any inflation yet. Put it this way, no inflation in world history ever started with the price of gold, silver, sugar, lumber, cotton, grains, meats, and metals caving in.

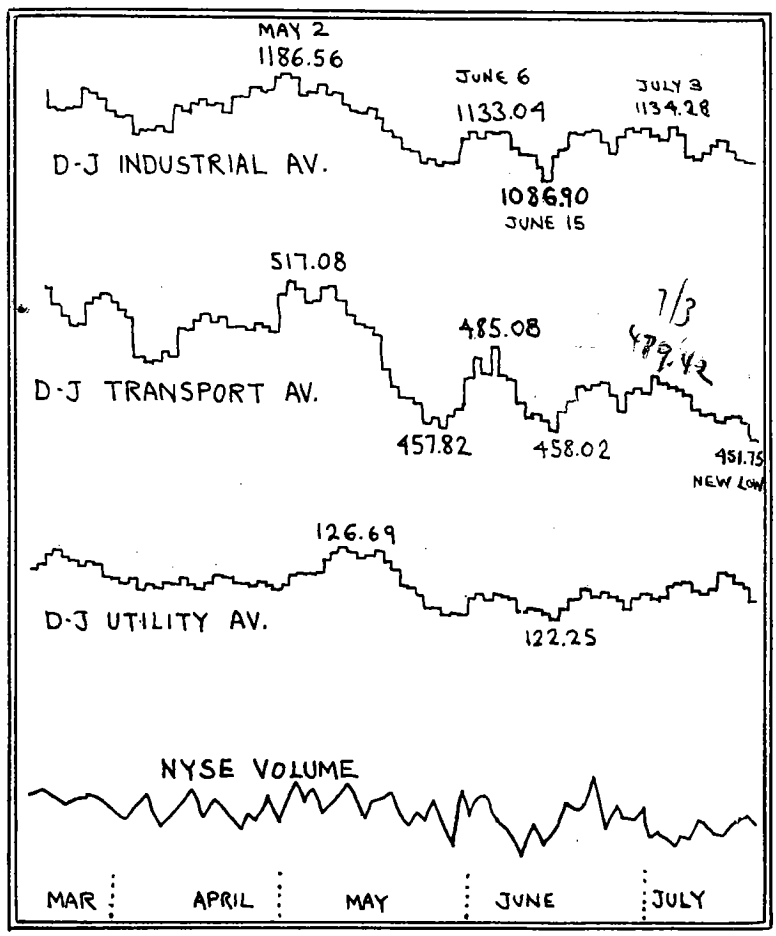
Corporate profits: Corporations are paying 13% and up to borrow money, but with an avalanche of cheap imports, a high-priced dollar and no inflation, it is very hard to raise prices. So corporate profits could be in for a squeeze. Also, the *Bank Credit Analyst's* debit/loan ratio is telling us that profits are heading for a squeeze. That is probably one of the things that has been driving the stock market down.

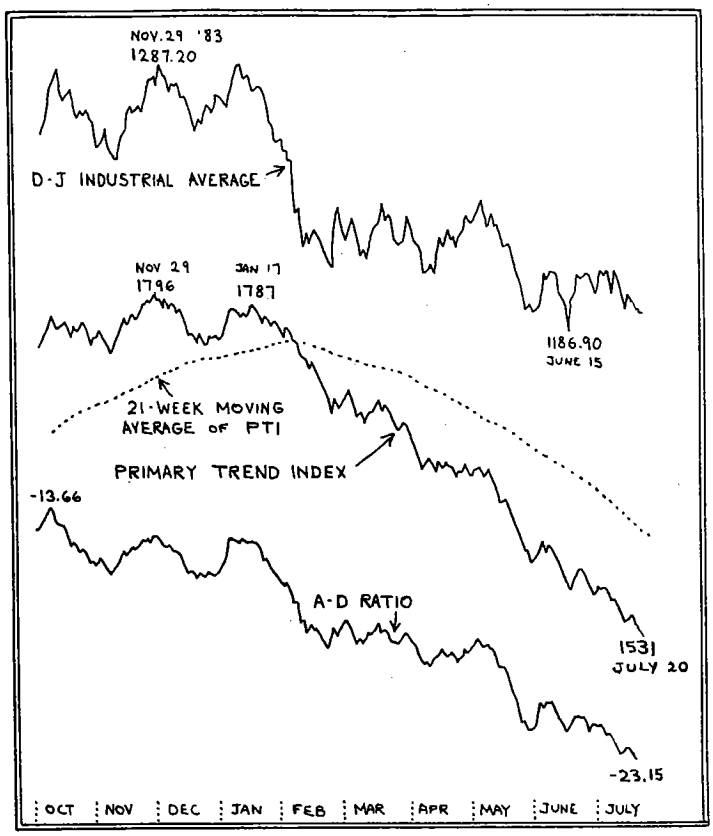
July 19, DJIA 1109.87; PTI 1547; A-D ratio –22.52
July 20, DJIA 1101.37; PTI 1531; A-D ratio –23.15

NEAR TERM: From a Dow Theory standpoint, we have been seeing a number of non-confirmations on the part of the Transports. At the mid-June lows (see page 1 chart) the D-J Industrial Average broke to a 1984 low of 1086.90, but the Transports refused to confirm (they held above their May low of 457.82). Then came a rally which took the Dow to a recovery high of 1134.28 (July 3). Here the Transports failed to confirm on the upside.

And that takes us to the present, wherein both Averages are fluctuating between the highs of 1134.28 and 485.08 on the high side and 1086.90 and 457.82 on the downside. A joint breakout above or below these points will set the next direction for the Averages.

Meanwhile, the majority of issues, as measured by the Advance-Decline ratio, have been sinking to new lows. But the new lows in the A-D ratio have not yet been confirmed by the big composite averages such as the S & P 500 or the NYSE Composite Index. The bear market lows for these Averages (check the closing each



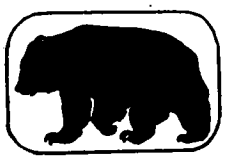


day in your daily paper) are 149.03 for the S & P 500 and 86.17 for the NYSE Composite.

The picture on my Primary Trend Index has been very poor. The PTI (see page 2 chart) has been recording a series of new lows, thereby confirming the new lows on the A-D ratio. So far, all rally days have put minor pointage on the PTI while downside days have taken off big pointage.

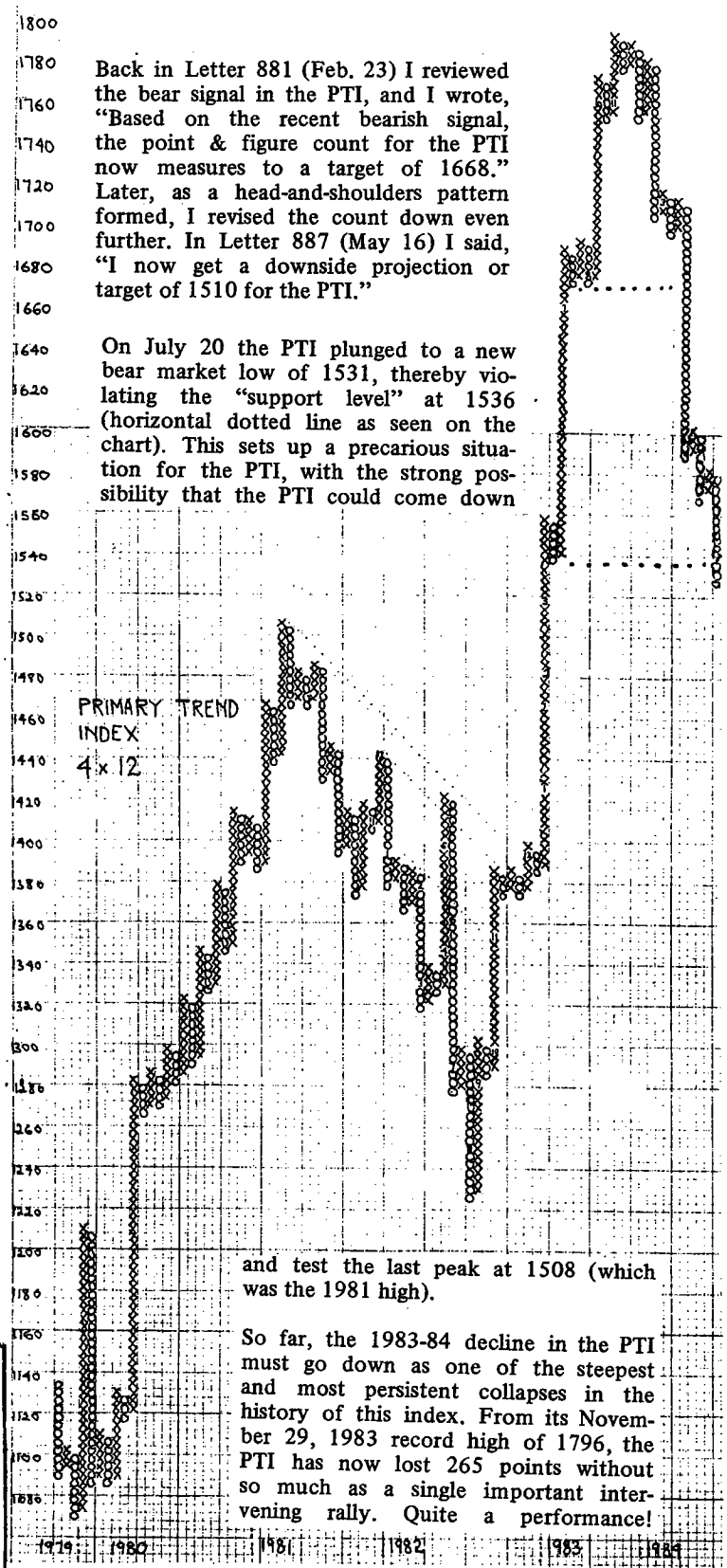
Conclusion: is that the trend continues down, but further downside confirmation must be provided by the various averages. One item of special interest is the D-J Utility Average. This Average, often a bellwether, was trending up until July 19 when a sharp break took it below 124. The Utility low for the bear market was recorded on June 15 at 122.25. Watch that figure. Holding above it—or a violation of it—will be highly significant.

INVESTMENT POSITION: I guess the simplest way in the world to invest with the major trend is to follow the PTI. Since its February 6 bear signal (at which point the PTI dropped below its 21-week moving average) the PTI has never faltered and it has never been easier to read. It's just been going steadily down, regardless of what the Dow or any other average has done.



When the PTI is in a decisive downtrend, we investors get on the sidelines. And that's where we're now. Despite the better bond market, the stock market has been sliding. So it's hold shares at your own risk; and my studies say it's a poor risk.

BONDS, MONEY RATES: Ever since late-June (Letter 890) I've been suggesting that bonds may have bottomed and



Back in Letter 881 (Feb. 23) I reviewed the bear signal in the PTI, and I wrote, "Based on the recent bearish signal, the point & figure count for the PTI now measures to a target of 1668." Later, as a head-and-shoulders pattern formed, I revised the count down even further. In Letter 887 (May 16) I said, "I now get a downside projection or target of 1510 for the PTI."

On July 20 the PTI plunged to a new bear market low of 1531, thereby violating the "support level" at 1536 (horizontal dotted line as seen on the chart). This sets up a precarious situation for the PTI, with the strong possibility that the PTI could come down and test the last peak at 1508 (which was the 1981 high).

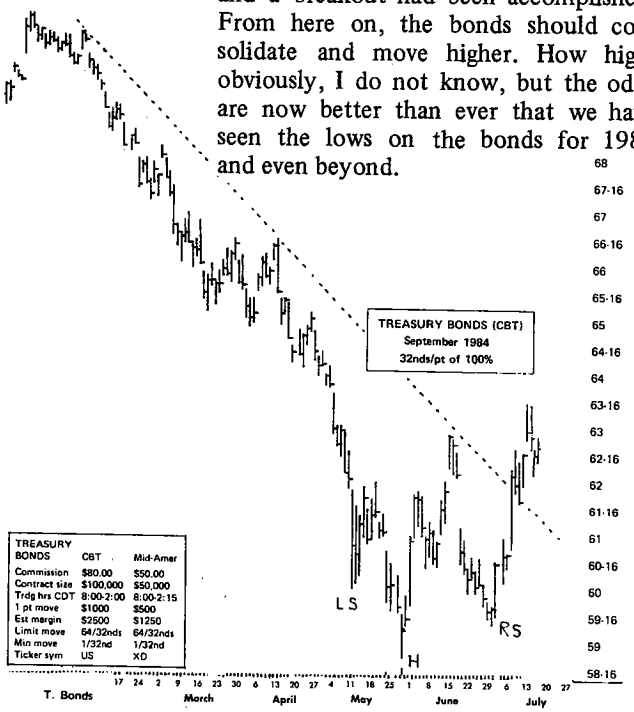
So far, the 1983-84 decline in the PTI must go down as one of the steepest and most persistent collapses in the history of this index. From its November 29, 1983 record high of 1796, the PTI has now lost 265 points without so much as a single important intervening rally. Quite a performance!

interest rates may have topped out. The Page 3 chart (courtesy of Dunn & Hargitt) updates the story. The extreme low was hit for the bonds on May 30 at just over 58½ on the September contract. A rally took the bonds to the major declining trendline, and the next decline brought the bonds back to the 59½ level. It was here that I said that a potential head-and-shoulders bottom had formed.

Then in early-July the bonds advanced to the 63½ level, and at this point it was clear that the downtrend line had been reversed

(continued from page 2)

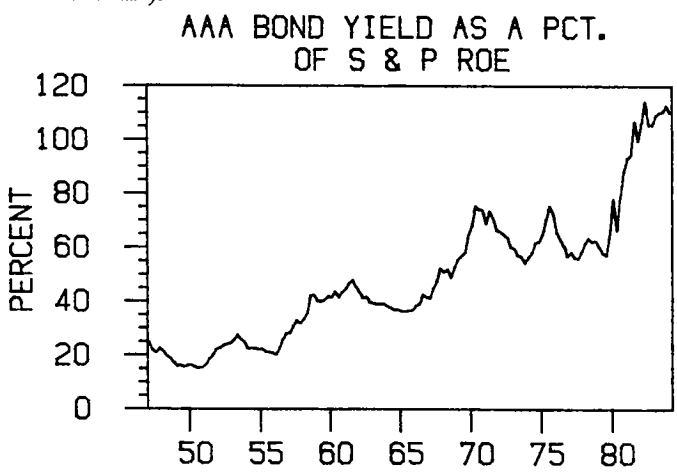
and a breakout had been accomplished. From here on, the bonds should consolidate and move higher. How high, obviously, I do not know, but the odds are now better than ever that we have seen the lows on the bonds for 1984 and even beyond.

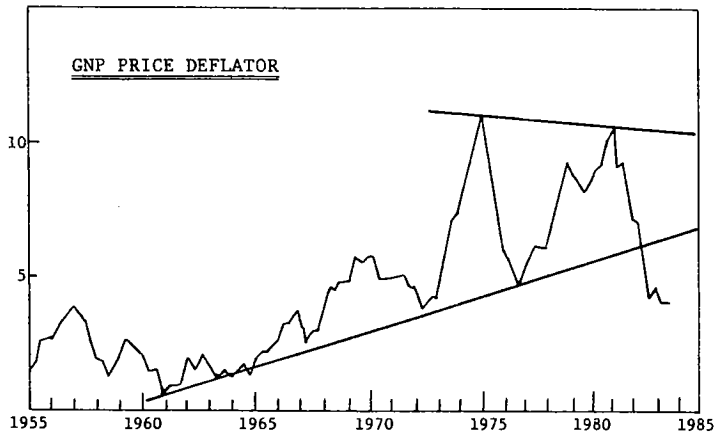


TREASURY BONDS	CBT	Mid-Amer
Commission	$80.00	$50.00
Contract size	$100,000	$50,000
Trdg hrs CDT	8:00-2:00	8:00-2:15
1 pt move	$1000	$500
Est margin	$2500	$1250
Limit move	64/32nds	64/32nds
Min move	1/32nd	1/32nd
Ticker sym	US	XD

THE TWO CHARTS OF THE YEAR: The first illustrates a phenomenon that I discussed in Letter 891, page 3. That is that the yield on high-grade bonds is now (for the first time in 115 years) HIGHER than the return on equity. In other words, the yield on bonds (and I'm talking about AAA bonds, the highest rated) is higher than the return on stocks (and when I say return on stocks I'm not referring to dividends, I'm referring to the total earnings). This chart (courtesy of Davis, Skaggs & Co.) shows the ratio of AAA bond yields to return of equity from the late-1940s to the present. Compared with bonds, stocks are now more expensive than at any time in a century.

The second chart (Cleveland Federal Res. Bank) shows the Price Deflator of Gross National Product used by the Fed. Here we see a 25-year trend broken and broken decisively. Is this the early harbinger of deflation? Only time will tell, but any time a quarter century trend is shattered, I'm interested (thanks to "The Primary Trend" service, 700 N. Water St., Milwaukee, WI 53202 for this chart).





INFLATION? My friend Jim Blanchard (he puts on the big New Orleans hard money seminars) in his publication, *Market Alert,* starts this way: "The Trillion Dollar Sure Thing . . . The next inflationary tidal wave approaches."

Now Jim may be right, the tidal wave of inflation may be approaching, but to be truthful, I don't see it in my charts—at least not yet. I know all the arguments. Everybody (and particularly the banks) needs money, and rather than let the system sink into financial oblivion, the Fed will print whatever is needed (well, they won't print it but they will extend guarantees and credits). Those guarantees and credits will flood the world with new money, and we'll be over our head in inflation before you know it.

That's the scenario, but so far it isn't happening. The US dollar continues to confound the experts by staying strong, superstrong. Would this be happening if dollar holders saw inflation just over the horizon? Well, hardly. And then there is the question of actual prices. The commodity idexes are collapsing and almost everything from heating oil and leaded gas to lumber to the grains to copper to gold and silver are in bear market downtrends. Now that isn't inflationary, is it? Then I picked up the July 11 issue of the WSJ and right on the front page I saw all four of these items. And they seem to smack of deflation, don't they?

My own feeling is that if the inflation tide is coming, we'll see it. We'll see it in the price of gold if nothing else. In the meantime, I'm sure not making any predictions about a new tide of inflation. A trend, once in force, is taken to remain in force until proved otherwise. Take it from me, the trends now in force are DEFLATIONARY. If there's a change, I'll report it here. In the meantime, make any forecasts or guesses you want—but don't ignore what's actually happening.

A DIVIDEND CUT by ITT Corp. to 25 cents from 69 cents a share was announced. The firm also said its second-quarter net will decline about 50% from a year earlier and lowered its 1984 earnings forecast.

(Story on Page3)

* * *

AT&T will freeze the salary structure for its 114,000 managers companywide. The freeze, spurred by a need to trim costs, should save AT&T nearly $184 million in 1985 expenses.

Most commodity futures fell broadly, continuing a pattern of disin-

flation in U.S. raw-materials prices. Favorable weather in the farm belt accelerated the trend by removing the threat of crop failure.

Diesel-engine sales have been steadily declining as gasoline prices fall, affecting parts suppliers, mechanics and others. After peaking at 6.1% of the new-car market in 1981, diesels sank to a scant 1.5% in the first five months of this year.

QUESTIONS, ANSWERS: I don't like to bore veteran investors with basic problems, but I have received so many questions about bonds and how to buy them, that I feel that this is the time to write this piece.

Question: Why buy bonds at all? Won't bonds be killed (as they have for decades) by inflation?

Answer: It is true that bonds have been in a bear market ever since 1946. This four-decade bear market is probably the longest trend in the investment world today (except for the rise in US debt). But ultimately, every trend in the financial world comes to an end. The debt trend in the US will come to an end in one of three ways. (1) The government will return to sanity and cut spending (while raising taxes). (2) A Constitutional Convention will mandate that the federal budget be balanced (and such a Convention could be a lot nearer than most Congressmen like to think). Or (3) A financial crisis of shattering proportions will terminate the US system as we know it today.

It strikes me that interest rates are now so high and their level as a function of the deficits is now so widely accepted that the time has come for the Congress to abandon its cowardice and take action. That action should (must) begin next year. That's one side of the bond equation.

The other side of the equation is this. Bonds now represent great values compared with stocks. When this happens, it becomes advantageous for a corporation to issue more equity than it does for a corporation to issue bonds. Also, consciously or unconsciously the investor starts moving towards bonds in preference to both stocks and private business enterprises. If you can receive a guaranteed 13.6% rate of return on a T-bond, why should you buy a stock that is selling for 15 times earnings and yielding say 4%? The answer is that the only reason you would buy such a stock is that you expect great future growth from that stock. But at 13.6% you don't need "great future growth," you've got it all right now–with minimum risk!

Consider this: a Californian can buy the general obligation muni bonds of his state at a yield of 10.25%. In order to do that well in another area (such as his own business) he must earn 21% before taxes. And he has to work hard to get that 21%. So instead of buying real estate or investing in a new business or buying stocks, he buys Cal GO's. And that's the value side of the bond market today.

Question: How do I buy bonds?

Answer: The way I like to do it is to check with a few banks and brokers all at the same time. Tell them what you want. For instance, you say, "Charlie, I want T-bonds maturing around 1995. I can use about 50 bonds ($50,000 worth of bonds). I want high current yield rather than discounted bonds. See what you can come up with." Or you say, "I want AA rated munis from any top states such as Illinois or Texas or California. I'll go out 10 years (bonds to mature around 1994), and watch the call price. Since discounted bonds are less likely to be called, I'll take any bonds in the mid-80s (i.e., bonds selling around 850) as long as they have a current yield of near 10%.

Question: What do you mean, current yield?

Answer: Current yield on a bond is determined by dividing the coupon value by the actual market price. In other words, if a discounted bond with an 8% coupon is selling in the market for 80, the current yield is 10%. But if that bond matures in ten years and it is then redeemed for 100 you will be gaining 10 points in the next 10 years on top of the coupon yield. Thus, you also have a "yield to maturity," which may be 10.4%.

Question: What about the call feature of bonds?

Answer: Many bonds have a call feature, such as a certain bond may be called at 96 in 1990. Thus, if interest rates happen to come way down this particular bond may be selling for 105 in 1990. The issue may be able to refinance the bond at a lower rate, and the bond will be called. Since you own the bond and it is now 105, the call means that you will have to take a loss on the market price (but not necessarily on the price you paid for it). You will also have to go out and buy another bond at probably a lower rate of return.

One way of avoiding calls is to buy a non-callable bond. Another way is to buy a discounted bond. The issuer will not call a bond at 95 if it is selling in the market at 89. Thus discounted bonds are a protection against a call.

Question: I called my broker for a quote on Treasury bonds, but I got a higher quote than the quote listed in the paper. What's wrong?

Answer: Those quotes in the paper refer to round lots of a million dollars or more. Anything less is considered an odd-lot in Treasuries, and you will not get the same low quote. Also, your broker's quote includes a commission.

When it comes to banks or brokerage houses, many of them have an assortment of bonds in inventory, and of course these are the ones they like to sell. But they will go "out into the market" to locate a certain bond if you push them to do so. You can buy as few as five bonds if you wish, but you will pay higher prices than the quote or than you would on a large lot. And here's something else that most investors don't seem to know. If you want to buy a certain bond (and this is particularly true of munis where the market may be thin and the bid and asked spread large), you can simply make a bid on it. If the broker asks say 85 for a certain bond, you can offer 82 or 83 and see what happens . Often you will get a better price, and there's little lost by making a bid to the broker on a "take it or leave it" basis.

NOTES & QUOTES: Malcolm Forbes had an accident on his motorcycle up in Kalispell, Montana, and he landed in the hospital. Being a cycle rider since 1961, I can sympathize with Malcolm. when you hit that highway, it hurts! And I've done it). But don't give up the bikes, Malcolm, just watch the curves, and do what every cycle rider must do to survive–*anticipate.*

I'm particularly obliged to Uncle Malc for including Ashby Bladen's fine column in the pages in every issue of Forbes. Bladen's current column is a beaut, and his explanation of what's happening now contains three of the best explanatory paragraphs I've seen anywhere. Here they are:

The other side of that coin is that the overvaluation of the dollar is pricing our exports out of world markets and making it steadily more unlikely that we will be able to repay our debts at anything like the dollar's present value. When it comes down our inflation will go up automatically. That is one reason why the bond market is discounting much higher future inflation.

It is not the only reason bond yields remain high. The devastating experience of deflation and depression in the 1930s has made avoiding

their recurrence the overriding political imperative of our generation. The result is a political commitment to keeping the good times rolling by running a huge federal deficit and by bailing out all the overextended borrowers.

This commitment threatens to produce a burden of debt service charges that could not be carried unless incomes were increased even faster by a steadily accelerating inflation. We must soon make a deliberate political decision *not* to bail everybody out and to face the deflationary consequences, or else the inflationary choice will be made for us. No question: Continued temporizing will amount to a choice of the inflationary alternative. But that decision cannot possibly be made before the November elections. Meanwhile, the demands for credit will remain more or less infinite, and interest rates have nowhere to go but up. Keep that in mind, and you can avoid getting whipsawed in today's volatile markets. ■

* *

International Notes: Jaguar, a great car name of the past, is fast becoming a great car name again. With miniscule USA sales of 1,000 Jaguars in 1980, the company will sell 15,000 Jaguars here in 1984. Next year Jaguar will come out with an all new 6 cylinder 24 valve engine, its first all new engine since 1949. The 1984 Jags are GOOD cars and beautiful cars. They are also the best value in the upper price (over $30,000) range. Take it from me, I'm an old Jag nut.

Eleven (count 'em) Japanese companies are preparing to attack the US computer market with under $500 sets. They will make their big push this January. Some of the companies are already household names such as Sanyo and Yamaha. The big competition is coming.

* *

When I first started in the advisory business back in 1958 there was just a handful of market newsletters. The pages of Barron's in 1958 contained maybe five ads a week for various services, most of them institutional such as Standard & Poor's, Value Line and Moody's. During the early '60s Jim Dines, Joe Granville and Harry Schultz entered the field and towards the mid-'60s a dozen or more new people joined.

According to George Schlieben (National Directory of Investment Newsletters) the number of newsletters has now risen to 1250. Schlieben estimates that 500,000 subscribers spend $500 million a year on the letters. Roughly 50% of the new reports fail, says Schlieben. On average, newsletter readers get 4 to 5 newsletters each. Schlieben says that they tend to be information junkies.

In my own view, I would guess that about 30 of the 1250 newsletters have any large, informed following and exert any real influence on market thinking. About a dozen (this is my estimate) make important money for their publishers.

I read probably 50 reports a week. My criteria are (1) Are the writers honest? (2) Are they intelligent and original? (3) Do I really know any more about ANYTHING after reading the report? (4) Does the report have a fundamental understanding of markets or the economy? (5) Does the report have a valid historical overview, or is it just dealing with today's events?

Over the last month I have been hearing that subscriptions and renewals to newsletters have been collapsing. Many newsletters have cut their advertising and promotionals. Happily, business here is still very good. I suspect this is because my subscribers have avoided severe losses, particularly in gold but in stocks and bonds too. Many of my fellow newsletter writers are now discouraged, and I can only tell all of you—"Sit tight. Nobody ever said this was an easy business." It takes pretty good nerves to stick it out in this business, plus some luck and the usual quantity of brains. But perhaps most important is what I term "staying power." In a quarter century of observing the people in the advisory business I note that the people who have staying power also possess a real FASCINATION with the markets, people like Zweig, Weinstein, Dines, Schultz, Prechter, Boeckh, Granville. These guys would (I'm sure) follow the markets just as intensely if they were retired and living in Xanadu.

* *

Many readers of these reports consider themselves "survivalists." I consider myself one. I've lived through a mastoid operation when I was 8, combat in WW II, a heart attack in 1971, a motorcycle crash on US 8, being lost in a B-25 over the Sahara in 1945, being held up at knifepoint in Harlem (NYC), and so forth.

Last week 15 miles south of here a madman shot and killed 21 people in the worst massacre of its kind in US history. Now there is no way you can avoid that kind of situation. Nobody expected it. Nobody could do much about it when it occurred. But there are other situations that come up, and survivalists like me can often smell the danger. Recently Ann Rule (an expert on "serial killers") was interviewed in USA Today. I thought the interview was excellent and informative, and I am including a part of it here for my survivalist readers. Read it carefully.

RULE: Each one has his own type. Ted Bundy likes very attractive co-eds with long, dark hair parted in the middle. John Wayne Gacy likes pubescent boys. The Green River killer is striking women who have some connection, however tenuous, with prostitution. When the killer is in a killing mode, it's whichever victim of his type that has the misfortune to cross his path who dies.

USA TODAY: How careful are serial killers in hiding incriminating evidence?

RULE: In the beginning they take tremendous pains. They may not know who the victim is, but they know how they're going to avoid detection. Then as the killings continue, they seem to get closer and closer together. At the end, there is kind of a killing frenzy, where there's some loss of control — and that's what puts them in the eye of the law.

USA TODAY: Can an individual avoid becoming the victim of a serial murderer?

RULE: The serial killer picks vulnerable victims he can control physically. So that includes women, children, the elderly, vagrants, prostitutes, homosexuals. When I checked back on Ted Bundy's victims and what they were doing at the time he got them, I found that without exception, something had gone wrong in their lives so that they were not paying full attention to what was going on around them. Some of them weren't wearing either glasses or contact lens. Some had had fights with their husbands or boyfriends. Some had the flu. Some were running away from home. The serial killer seems able to spot the weak sheep in a flock and cut it out, as a wolf might.

USA TODAY: Then, how do you protect yourself?

RULE: I tell women, particularly, when you have to walk alone, look alert. This is an awful thing, but the women who die, are the women who say, "This can't be happening to me." They're frightened into immobility. The women who have lived — who have gotten away from serial killers — were able to perceive the danger at once and say, "This is happening to me, and I've got to do something about it," and they fought.

USA TODAY: How is it possible that someone can kill more than a hundred people — as Henry Lee Lucas has claimed — without getting caught?

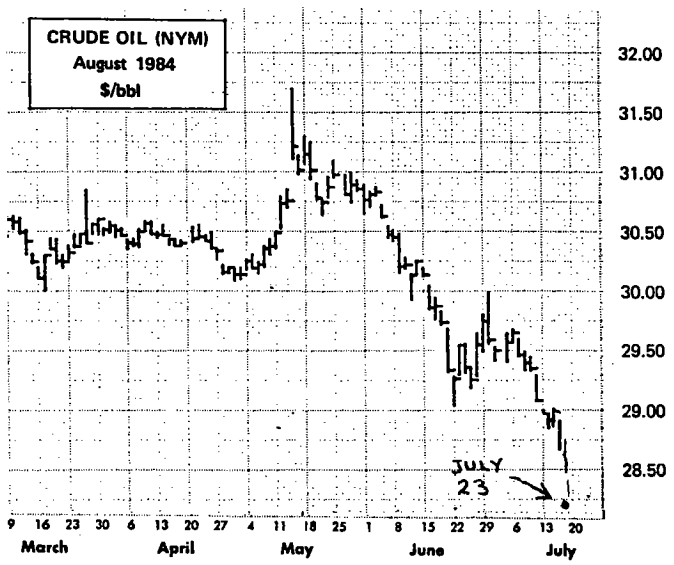
RULE: It's a matter of mobility. Most serial killers are very intelligent, clever, cunning and manipulative. For those who may not rank way up there on the I.Q. chart, you have the killers who are streetwise and con-wise. They can deliberately or subliminally know if they keep moving and roving like the shark who eats anything that comes in front of him — it's going to be very difficult for one area, one police department to pick up on them. We have no centralized network that will allow police departments to compare notes on unsolved homicides.

With the slump their big export item, gold, S. Africa has had to prop up the rand. And when S. Africa moves, it doesn't fool around. This little squib from the NY Times shows how they do it.

> **JOHANNESBURG, July 16 (Reuters) — Major South African banks announced today that they were raising their prime lending rates to a record high of 22 percent from 21 percent.**

GOLD: As veteran readers know, I like to write about what's happening in the world of markets, economics and investing. Sometimes I wish I could put out a special report on commodities, because what's happening there today is, I feel, most significant. What's happening is that the majority of commodities are falling apart. In many cases, the breaks are frightening. World sugar at $4.75 per pound looks like it's about to be given away. Cotton just broke wide–again. The metals you know about. The grain complex is very weak. The meats are now breaking rising trendlines. Lumber has collapsed.

The fact is that it's a picture of deflation–there's no other word to describe it. I include on this page a daily chart (courtesy of Dunn & Hargitt) of crude oil (August contract), and here too we see the pressure of deflation. Crude has just



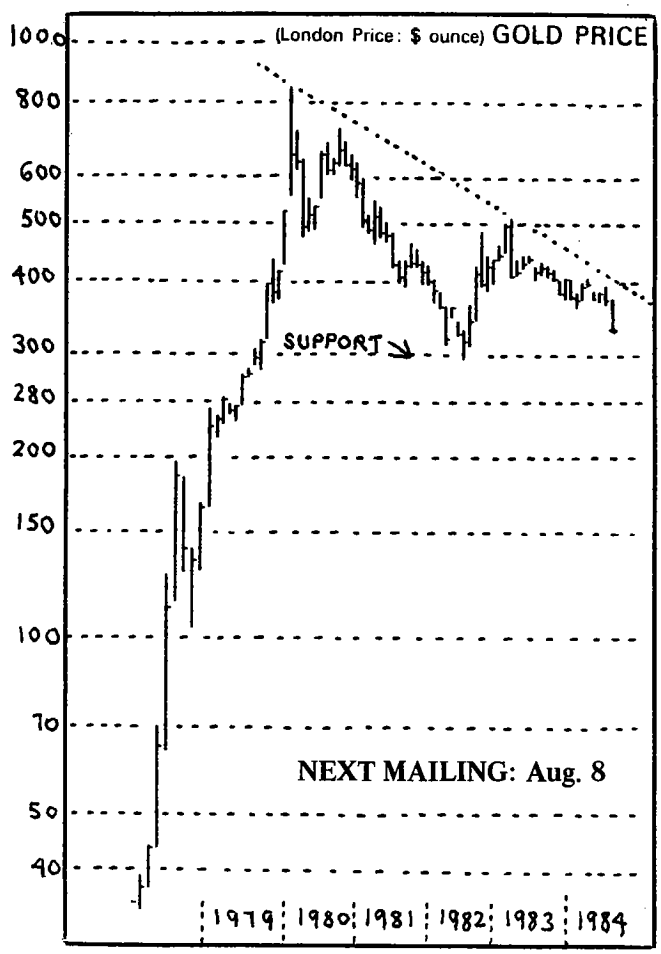
plunged through the $29 support area, and I find this particularly ominous in a world where Iraq and Iran are still fighting. Oil or black gold is a key commodity, a commodity which finances many nations from Mexico to Venezuela to Saudi Arabia. I don't care what you think is "going to happen," I don't care what inflation scenario you have been reading about, the *fact* is that deflationary forces are now building up. I see them on the commodity charts. That's what's occurring NOW.

With gold idling in the mid 350s, I'm amazed to see most hard money people continuing to say that the "long term trend is still up, so don't sell your long term holdings." This is the kind of stubborness that so often leads to disaster in this business. The hard money boys have an inflation scenario in their heads, and no matter what gold actually does they excuse it because they are hanging on to that inflation scenario.

I've tried to teach my subscribers to have utmost respect for the markets. We don't survive on scenarios, we invest and stay in business by buying values and staying with the trend. On the New York Futures Exchange the floor traders walk around with little buttons in their lapels which read, "The Trend is Your Friend." Which, of course, is true if you happen to know what the trend is–and invest accordingly. The lesson is that you're better off investing in bat guano if the trend is up than you are investing in gold if the trend is down.

I include a gold chart here courtesy of *Capital International Perspective* out of Geneva, Switzerland. The chart is a long term ratio chart, and we get an interesting and rather unique picture of gold here. First we see the extraordinary rise from $35 back in the early 1970s to the 1980 blow-off top of 850. Since then gold has formed a series of descending peaks, and the picture is of a well-established bear market.

The obvious level of major support is now the 295-300 level. If that level is decisively violated, it would not surprise me to see gold crash down to 200 support area. From the "looks" of this chart and based on my experience with similar formations, I would say that the odds favor gold breaking below 300. But gold is unlike any other substance (since it is real money), and it may be that 300 will hold (but–I am skeptical).



LATE NOTES: The week ending July 20 provided us with another new low on the D-J Transportation Average, a low not (yet) confirmed by the D-J Industrial Average. With the new Transport low, the 1984 low of 1086.90 (Industrials) assumes key importance. If Industrials break 1086.90, then we have a downside confirmation, and the bear market will gain new life. However, a *persistent refusal* to break the 1086.90 level could set up a summer rally attempt. Meanwhile, the PTI broke to a new low of 1531 and the A-D ratio confirmed with a new bear market low. Hardly a happy picture–but it's reality.